



## **REPORT OF THE AUDITOR-GENERAL TO MEMBERS OF THE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS OF MOOKGOPHONG MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006**

### **REPORT ON THE FINANCIAL STATEMENTS**

#### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Mookgophong Municipality which comprise the balance sheet as at 30 June 2006, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages ... to ....

#### **Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the standards determined by the Institute of Municipal Treasurers in its Code of Accounting Practice (1997) and Report on Published Annual Financial Statements (second edition – January 1996), which constitute an entity specific basis of accounting. This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

#### **Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

#### **Basis of accounting**

4. The municipality's policy is to prepare financial statements on the standards determined by the Institute of Municipal Treasurers and Accountants in its Code of Accounting Practice (1997) and Report on Published Annual

Financial Statements (second edition – January 1996), which constitute an entity-specific basis of accounting.

### **Basis for disclaimer of opinion**

#### **Fixed assets**

5. An amount of R3 482 878 is reflected in the financial statements for fixed assets. Management did not implement adequate control measures over updating and maintenance of the asset register of the municipality. The following control weaknesses were identified during the execution of the audit:

- No dates of purchases were recorded for new assets acquired.
- No descriptions are provided on the asset register for new assets acquired.
- The physical location of new assets acquired is not stated in the asset register.
- No asset numbers or any other forms of identification were allocated to any fixed assets on the asset register.
- There is no detailed information in the asset register regarding the disposal of assets.
- The fixed asset register does not indicate amounts received or the resultant profit or loss for assets that were disposed off.
- There is no information relating to the physical condition of the asset in the asset register.
- Land owned by the municipality is not reflected in the asset register.

In view of the above, I have not been able to obtain sufficient appropriate audit evidence to satisfy myself regarding the existence, completeness and valuation of the fixed assets recorded in the financial statements of the municipality.

#### **Inventory**

6. An amount of R852 256 is reflected in the financial statements for inventory. No satisfactory listing or reconciliation could be provided by the municipality as at 30 June 2006 to substantiate this amount.

#### **Bank and cash**

7. An amount of R4 309 116 is reflected in the financial statements for bank and cash. The municipality did not prepare a year-end bank reconciliation and as a result I could not obtain sufficient appropriate evidence that the cash figure of R4 309 116 in the financial statements is recorded at the appropriate amount and any resulting valuation or allocation adjustments were appropriately recorded.

### **Creditors**

8. The financial statements reflect an amount of R433 844 as trade creditors. No documentation supporting this amount could be provided for audit purposes. Furthermore, the municipality had not prepared any creditor's reconciliations at year-end.

### **Provision for leave pay under provided**

9. Provision for leave pay is reflected on the financial statements at R1 105 825. According to my calculations the leave pay provision should be R1 635 435, resulting in an under provision of R529 610.

### **Differences between Value Added Tax (VAT) 201 returns and the statements**

10. VAT is reflected at R1 166 733 under debtors in the municipality's financial statements. However, according to the submitted VAT 201 returns for the financial year, R16 161 038 and R14 970 606 was declared as VAT output and VAT input respectively resulting in a VAT creditor of R1 190 432. The municipality could not provide any explanations for these significant differences.

### **Inadequate recording and managing of traffic fines**

11. During the financial year traffic fines were not recorded on an appropriate system. No reconciliation or list could be provided by the municipality to indicate what fines were issued and paid during the financial year. As result, I could not obtain sufficient evidence to satisfy myself that traffic fines amounting to R110 600 have been completely recorded in the municipality's financial statements.

### **Differences between the general ledger and the statements**

12. The annual financial statements reflect employee costs at R18 151 821 while the general ledger reflects an amount of R15 898 607, resulting in a difference of R2 253 214. The municipality could not provide me with information on how they arrived at the amount reflected on the statements.

### **Debtors balance misstated**

13. The outstanding debtors list at year-end as produced from the financial system of the municipality amounted to R8 428 510. The balance of debtors in the financial statements amounts to R7 480 778, resulting in a difference of R947 732. No explanations could be provided for this difference.

### **Provision for doubtful debts**

14. The provision for doubtful debts included in the financial statements amounts to R3 834 595. The provision was not calculated based on any policy. This amount was determined by the financial manager and despite the increase in debtors in the current financial year the provision remained constant from the prior year. Furthermore, based on my audit of debtors an amount of R4 194 794 is irrecoverable which confirms that the provision for doubtful debts has been misstated.

**No list of water meters could be provided**

15. The municipality could not provide me with a list of all water meters registered at the municipality, hence I could not obtain sufficient appropriate evidence to conclude whether revenue amounting to R4 576 023 from the rendering of water services has been completely and accurately recorded in the municipality's financial statements.

**Incorrect recording of interest income**

16. Interest earned on investments to the amount of R2 413 746 was credited to a suspense account and allocated directly to the statutory funds and reserves instead of the income statement. As a result, the income statement has been understated by the above amount

**Incorrect valuation of investments**

17. A difference of R585 507 was noted between the investment confirmations received from the financial institution and the amount recorded in the financial statements of the municipality. This difference had not been investigated and rectified at year-end.

**No documentation for sale of stand debtors**

18. No documentation supporting the amount of R572 626 for the sale of stand debtors as disclosed in the financial statements could be provided for audit purposes.

**Disclaimer of opinion**

19. Because of the significance of the matter described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Mookgophong Municipality. Accordingly, I do not express an opinion on the financial statements.

**OTHER MATTERS**

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

**Fruitless and wasteful expenditure**

20. The municipality requested an update on the valuation roll during 2003 but it was never completed by the appointed consultant. An amount of R 374 720 was paid in total to for the uncompleted work. The original contract value was R468 400. Furthermore, details of this expenditure were not disclosed in the financial statements as required in terms of section 125(d) of the Municipal Finance Management, 2003 (MFMA). This incident should have also been reported to the relevant parties, as stipulated in section 102(1) of the Act.

### **No appropriate control procedures for VAT input claims.**

21. During the audit, I established that the current control measures in place are not sufficient to prevent incorrect claims for VAT inputs. During the audit, I discovered from my sample that the municipality had claimed VAT input of R178 258 on invoices that did not meet the requirements of a valid tax invoice in terms of section 20 of the Value Added Tax Act, 1991.

### **Capacity building not sufficient**

22. Based on audit work done and discussions held with management, I am of the opinion that the municipality does not comply with section 68 of the Municipal Systems act, 2000, in that it did not develop its human resource capacity to a level which enables it to perform its functions and exercise its powers in an economical, effective, efficient and accountable way. The municipality struggles to perform its duties because of a shortage in qualified personnel. There are also a high number of vacancies on senior post levels, which cause the Municipality to have to function without certain departments for example Internal Audit, Supply Chain Management, IT Management, etc.

### **Fringe benefits calculated incorrectly**

23. The fringe benefits earned by employees who rent council houses were incorrectly calculated and taxed according to the paragraph 10A (1) of the seventh schedule of the Income Tax Act, 1962. The amounts disclosed to the South African Revenue Services (on the IRP5 forms) relating to these fringe benefits were less than the actual benefit in terms of the tax act. The taxable amount reflected on the IRP5 documents amounts to R14 363. According to my re-calculations, the taxable amount should have been R34 096.

### **Non-compliance with laws and regulations**

24. During the audit, the following non-compliance issues with the relevant laws and regulations applicable to the municipality were identified:
- Management accounts were not submitted to the mayor or the relevant provincial treasury from November 2005 to April 2006. According to section 71(1) of the MFMA, the accounting officer must by no later than 10 working days after the end of each month submit to the mayor of the municipality and the relevant provincial treasury a statement in the prescribed format on the state of the municipality's budget reflecting particulars for that month and for the financial year up to the end of that month;
  - I could not find any proof that the accounting officer performed a mid-year budget and performance assessment in terms of section 72(1) of the MFMA. No report was submitted to the mayor, national treasury or the relevant provincial treasury;
  - The municipality submitted its financial statements for audit on 30 January 2007. This is in contravention of Section 126(1) of the MFMA, which requires a municipality to submit its financial statements not later than 2 months after its financial year-end.

- The mayor did not submit quarterly report to the council on the implementation of the budget and the financial state of affairs of the municipality as required in terms of S52(d) of the MFMA.
- In terms of section 66 of the MFMA, the accounting officer of a municipality must, in a format and for periods as may be prescribed, report to the council on all expenditure incurred by the municipality on staff salaries, wages, allowances and benefits. No such reporting was done.

#### **Internal control weaknesses**

25. The following internal control weaknesses were identified during the course of the audit:

- The municipality does not have a formally documented and tested disaster recovery plan in place for the recovery of the various application systems in the event of a disaster.
- Delegations of authority were not sufficiently defined.
- There is no communication to employees concerning their leave balances. Employees with leave accruals greater than 48 days could have their remaining extra leave days forfeited.
- A formal risk assessment strategy that should address both internal and external, physical, financial, operational and compliance risks to which the municipality is exposed has not been compiled. Such a strategy should have also had a fraud prevention plan in place.
- There is a lack of adequate controls over the administration of leave. As a result, significant differences were noted between the leave records and the leave register of the municipality.
- Various departments operate with a staff component and specific positions that were established years ago. Some of these positions might not be required currently and other departments may require further assistance to ensure adequate control over the municipality's affairs.

#### **Prior Year issues**

26 The matters mentioned in paragraphs 27 to 30 were raised in writing with the municipality on 17 May 2006 and again on 5 January 2007.

#### **Land Purchases**

27. During January and February 2005, the Municipality purchased three farms at a total cost of R3,145 million. Scrutiny of the procurement process followed by the Municipality revealed the following shortcomings;

- A fair and transparent process, with regard to the identification of estate agents to be used for the transactions, was not followed.
- In one case a farm bought by the municipality was openly advertised (in November 2004) by another estate agent for R250 000 less than the

amount paid by the municipality, as a result fruitless and wasteful expenditure to the amount of R250 000 has been incurred.

- A Councilor involved with the identification of farms to be acquired, had an undisclosed business relationship with one of the estate agents utilised for the transactions and appeared to have earned commission amounting to R27 083.33.
- The municipality neglected to have the farms valued prior to the purchase and arranged for the valuation to be done in September 2005, seven months after the price had been agreed on.
- The purchase of the farms was neither budgeted for nor approved by National Treasury, therefore the expenditure of R3,145 million incurred in this regard is regarded as unauthorised expenditure as defined by section 1 of the MFMA.
- The project for which the farms were acquired was not catered for in the Integrated Development Plan of the municipality.

#### **Poverty relief fund**

28. During the financial year ended 30 June 2005 the council had a poverty relief fund which was entirely managed by the then Mayor. According to the poverty relief policy adopted by the council the targeted beneficiaries are; "both the starting as well as group of persons emerging from the previously disadvantaged groups within the Mookgophong Municipal Area who have or can demonstrate the ability and willingness via, e.g. an implementable project proposal that seeks to tackle areas of poverty within the local community" (*sic*). Allocations were made at the sole discretion of the Mayor and were never submitted to council for ratification. Due to insufficient information available, the link with "poverty relief" is not always clear and I cannot express an opinion with regards to the projects in respect of which funds were provided. It is possible that payments made from the donations fund were misallocated to the poverty relief fund.

#### **Repairs to the community hall**

29. The municipality appointed a contractor to renovate the community hall in December 2004. The renovations were done over the period January to March 2005. In my opinion the standard of workmanship was poor and the expenditure incurred amounting to R88,454.92 cannot be regarded as effective, efficient and economic use of municipal resources as required by section 62(1)(a) of the MFMA.

#### **Response by the Municipality**

30. Meetings were held with the then Municipal Manager and subsequent acting Municipal Managers on 17 May 2006, 5 January 2007 and 5 April 2007. The only response to these findings provided by management to date was a legal opinion submitted on 14 August 2006. This opinion is problematic in that it was compiled by one of the members of the municipality's Audit Committee and can therefore not be regarded as the opinion of management.

## APPRECIATION

31. The assistance rendered by the staff of the Mookgophong Municipality during the audit is sincerely appreciated.



A N Dzuguda for Auditor-General

POLOKWANE

7 August 2007



AUDITOR - GENERAL